Plan 3 Gain-Sharing

Background

In the Plans 3, active, retired and term-vested members receive gain-sharing distributions as lump sum dollar amounts deposited directly into their defined contribution accounts. The increases are contingent on the occurrence of extraordinary gains, which occur whenever the compound average of investment returns on pension fund assets exceeds 10% for the previous four state fiscal years. Since the implementation of gain-sharing in 1998 there have been two gain-sharing distributions.

Committee Activity

Subgroup Activity:
November 9, 2004 - Subgroup meeting
November 11, 2004 - Subgroup meeting
December 1, 2004 - Subgroup meeting

Presentation and Proposal:
December 7, 2004 - Executive Committee
December 7, 2004 - Full Committee

Recommendation to Legislature

Amend and replace Plan 3 gain-sharing, and remove the annual window for Plan 3 contribution rate changes, replacing them with the following:

1. A modified "rule of 90" for the Plans 2/3 that would allow all vested members with a minimum age of 60 to qualify for retirement if any combination of age and service equals 90, and with unreduced retirement benefits for prospective service credit;

2. Plan 2/3 choice for new members of TRS and SERS (using the same terms as currently exist for PERS); and

3. an annual employer contribution into the existing Plan 3 member accounts in SERS.

Staff Contact

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Plan 3 Gain-Sharing

(December 6, 2004)

Issue

The issue before the SCPP is whether to recommend legislation that would amend and replace Plan 3 gain-sharing, and remove the annual window for Plan 3 member contribution rate changes, replacing them with the following:

- a modified "rule of 90" for vested members of the Plans 2/3 with prospective unreduced retirement benefits and a minimum age of 60;
- Plan 2/3 choice for new members of TRS and SERS (using the same terms as currently exist for PERS); and
- an annual employer contribution into the existing Plan 3 member accounts in SERS.

Staff

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Subgroup Recommendation

At its meeting on November 9, 2004, the Purchasing Power/Gain-Sharing subgroup of the SCPP instructed the OSA staff to develop a proposal that would be brought to the December SCPP meeting. The proposal would involve a "tradeoff" of certain benefits that would replace Plan 3 gain-sharing benefits. Suggested components for the Plan 3 tradeoff included a rule of 90, five-year vesting for the Plans 3 and direct deposits into plan 3 member accounts. The target cost for the tradeoff package was to approximate half of the forecasted cost of future gain-sharing. No consensus was reached in the subgroup and staff was not given specific direction as to the elements of the tradeoff package.

Several draft proposals were outlined by staff for consideration by the subgroup. Staff provided a handout describing the draft proposals on November 11, 2004, and after additional feedback from several subgroup members, staff refined the package to include the three elements described above: modified rule of 90, Plan 2/3 choice and SERS 3 contributions.

On December 1, 2004, several subgroup members (Fromhold, Charles and Parr) met to consider the evaluation of two elements of the tradeoff package by tax counsel for DRS (Plan 2/3 choice and SERS 3 contributions). As the result of that meeting, it was determined that further negotiations were necessary among the affected member groups before a final proposal could come before the SCPP. On the afternoon of December 1, 2004, the OSA was given direction by Representative Fromhold (for the subgroup) to add a repeal of the annual member contribution rate flexibility in the Plans 3 in order to avoid problems with the IRS around the issue of Plan 2/3 choice.

The Executive Committee has not yet heard this proposal. This agenda item is to be considered by the Executive Committee prior to the full SCPP meeting on December 7, 2004.

Members Impacted

This proposal would impact the active, retired and terminated and vested ("term-vested") members of the TRS, SERS and PERS Plans 2/3. As of September 30, 2003, there were 277,618 members among these three categories (all systems combined). For detailed information regarding members impacted, see the draft fiscal note which is provided as a handout for the December 7, 2004 meeting.

Current Situation

Retirement Eligibility

Currently, with respect to normal retirement, Plan 2/3 members of TRS, SERS and PERS are eligible to retire with unreduced benefits when they are vested and reach age 65. The vesting period for the Plans 2 is five years. The vesting period for the defined benefit component of the Plans 3 is ten years, or 5 years if 12 months of service were accrued after attaining age 54. (Plan 3 members are immediately vested in the defined contribution portion of their benefit.)

Plan 2/3 Choice

Currently, of the three systems, PERS is the only one that has Plan 2/3 choice. New PERS employees have a period of ninety days to make an irrevocable choice to become a member of Plan 2 or Plan 3. At the end of ninety days, if a member has not made a choice to become a member of Plan 2, he or she automatically becomes a member of Plan 3. In TRS and SERS, new employees automatically become members of Plan 3, and the Plans 2 are closed to new hires.

Plan 3 Gain-Sharing

Gain-sharing is a mechanism that increases benefits. The increases are not automatic, but are contingent on the occurrence of "extraordinary investment gains." Extraordinary gains occur when the compound average of investment returns on pension fund assets exceeds 10% for the previous four state fiscal years. When this occurs, a calculation is performed to determine a dollar amount that will be distributed to eligible members. Gain-sharing calculations are currently made once each biennium with potential distributions occurring in January of even-numbered years. In the Plans 3 of PERS, SERS and TRS, active, retired and term-vested members receive distributions as lump sum dollar amounts deposited directly into their defined contribution accounts based on years of service credit. There have been two gain-sharing distributions since the inception of gain-sharing: one in 1998 and one in 2000.

Plan 3 Member Rate Flexibility

A current provision in the defined contribution portion of the hybrid Plans 3 allows members to change their contribution rate option annually by notifying their employer in writing during the month of January. This contribution rate flexibility has been implemented for TRS but has never been implemented for PERS and SERS because of its questionable status with the IRS. DRS has asked for IRS approval of this provision, but review has been pending for 2.5 years and no answer has been given.

Proposal

Modified Rule of 90 for Retirement Eligibility

With respect to retirement eligibility, the proposal would institute a modified "rule of 90" for vested members that uses an age 60 minimum, and that has unreduced benefits for prospective service only in TRS 2/3, SERS 2/3 and PERS 2/3. This modified rule of 90 means that a vested member who is at least 60 years old can retire when the sum of the member's age and the member's service credit years totals ninety or more. "Unreduced retirement for prospective service only" means that service credit accrued prior to the effective date of the bill, i.e. July 1, 2007, would be subject to any required reductions for early retirement. The portion of the benefit that is based on service credit accrued after July 1, 2007 would be unreduced. An example of the modified rule of 90 follows:

> <u>Example, Modified Rule of 90</u>
>
> Consider a Plan 2 member who is 60 years old and who earned the first half of his or her 30 years of service credit before July 1, 2007 and the second half of their service credit years after July 1, 2007. The member meets the minimum requirements for the rule of 90 because the member is vested, is at least 60 years old, and the sum of the member's age and the member's service credit years (60+30) equals 90.
>
> Because the rule of 90 provides unreduced retirement benefits on a prospective basis only, then one-half of the member's benefit is unreduced (for the fifteen service credit years earned after July 1, 2007), and one-half is subject to the required reductions for early retirement (the fifteen service credit years earned before July 1, 2007). Generally, the applicable benefit reduction for retiring 5 years earlier than the Plan 2 normal retirement age of 65 with at least 30 years of service is 3% per year as provided in the alternate early retirement provisions of the Plans 2. This means that the member's benefit would be reduced by 15% (3% x 5 years) for retiring at age 60. Under the modified rule of 90, only one-half of the benefit would be subject to that reduction (i.e. that half that was earned prior to the effective date of the rule of 90). One-half of 15% is 7.5%, so the total reduction of the benefit would be 7.5%.

Assuming an monthly retirement benefit of $1,000 (before reductions), the member that retires at age 60 without rule of 90 is subject to a 15% reduction, giving the member a monthly benefit of $850. With the modified rule of 90, the member's benefit is reduced by 7.5% (which is one-half of 15%), giving the member a monthly benefit of $925. For those hired after July 1, 2007, there will be no benefit reductions for retiring under the rule of 90.

Summary of Example - Modified Rule of 90:

	Percent Reduction	Monthly Benefit
Benefit Before Reductions	0 %	$1,000
Benefit Without Rule of 90	15%	$ 850
Benefit With Rule of 90	7.5%	$ 925

Plan 2/3 Choice

As another element of the tradeoff proposal, Plan 2/3 choice would be added for TRS and SERS members hired on or after July 1, 2007 (using the same structure for choice as is currently in PERS). New hires would have a ninety-day window to make an irrevocable choice to become a member of Plan 2 or 3. At the end of ninety days, if the member has not made a choice to become a member of Plan 2, he or she would automatically become a member of Plan 3.

Tax counsel for DRS has expressed concern over multiple elections (or choices) by members in the Plans 2/3, as the IRS does not allow a high degree of choice or member flexibility in 401(a) plans. Washington's Plans 3 fall within this category, as they are 401(a) defined benefit plans with a defined contribution component. DRS was advised of possible problems with the provision allowing annual member contribution rate flexibility if the Plan 2/3 choice provision was added for all plans.

Plan 3 Member Rate Flexibility

After considering the tax advice, and in order to retain the Plan 2/3 choice element within the tradeoff proposal, the subgroup recommended removing the provision for annual member contribution rate flexibility in the Plans 3. This latter provision, found in RCW 41.34.040(4), allows members to change their contribution rate option annually by notifying their employer in writing during the month of January. It should be noted that annual contribution rate flexibility has never been implemented for PERS and SERS because of its questionable status with the IRS.

Plan 3 Gain-Sharing

As the final element of the tradeoff, this proposal would eliminates Plan 3 gain-sharing for TRS and PERS, and retain an amended version of Plan 3 gain-sharing for existing SERS members. The SERS 3 provision was included because SERS 3 members get the least benefit of the three systems from a Rule of 90, and the provision would help provide more balance in the gain-sharing trade-off for all plan 3 members. Existing SERS 3 members (not new hires) would receive a uniform annual contribution of $10 to their defined contribution accounts that is increased by three percent (3%) per year rounded to the nearest cent, which is then multiplied by service credit years. Thus, the benefit increases for each additional year of service credit earned by the member.

> <u>Example, SERS 3 Contribution</u>
>
> Regarding the $10 SERS 3 contribution, the $10 would increase at 3% per year and the contribution amount would increase for each additional year of service. The typical SERS 3 member would receive a benefit with a present value of $2,200. A SERS 3 member with 11 years of service would receive an employer contribution of $110 the first year, and if the member remained employed by SERS, the member would receive $124 the second year and $544 the twentieth year.

The $10 per service credit year amount would continue to be deposited into each eligible SERS 3 member's defined contribution account for life, or until termination of employment if the member is not vested. Because this element of the tradeoff proposal applies to a closed group of existing employees (those hired prior to the effective date of the legislation), its cost will taper off in the future and eventually go away.

Policy Analysis

Modified Rule of 90 for Retirement Eligibility

A rule of 90 would move toward a more career-based retirement benefit for the Plans 2/3 in that younger workers would be rewarded for long-term public service by receiving an unreduced retirement benefit prior to the time at which they would normally be expected to leave the workforce. The cost of a life-time benefit for such individuals would be higher because the benefit would be paid over a longer period of time. Members who enter the workforce at age 40 and above would not benefit from the rule of 90 as there would be no combination of age and service that could result in a full retirement benefit earlier than age 65, the current normal retirement age for the Plans 2/3.

By making the rule apply prospectively only, the cost of this benefit is somewhat reduced. (Compare to the draft fiscal note for the "full" rule of 90, which is also part of the materials for the December 9, 2004 meeting.) Also, the minimum age of 60 lowers the cost of a rule of 90 and creates less departure from the age-based designs of the Plans 2/3. Finally, applying the rule of 90 prospectively avoids having new plan members pay for the past service of existing members, thus promoting inter-generational equity in funding the benefit.

For additional policy analysis, see the Age 65 Retirement Options report dated October 12, 2004 and the Age 65 Retirement Report dated September 1, 2004.

Plan 2/3 Choice

This element of the proposal would bring consistency for new hires in PERS, TRS and SERS. Currently, only those hired into a PERS position have Plan 2/3 choice. Generally, it is the legislature's policy and intent to provide similar benefits within the retirement systems of the state wherever possible. See RCW 41.50.005(1). However, if the intended policy is to move toward a plan 3 hybrid pension model (defined benefit plus defined contribution) for all new hires, this element of the proposal would conflict with that policy.

Plan 3 Member Rate Flexibility

As mentioned above, the subgroup was informed of advice from tax counsel to DRS expressing concern over multiple elections (or opportunities for choice) in the Plans 2/3. DRS was advised of possible problems with annual member contribution rate flexibility if the Plan 2/3 choice provision was added for all plans. It was also noted that contribution rate flexibility already has questionable tax status. The subgroup recommended elimination of contribution rate flexibility in the Plans 3 in order to avoid IRS problems. Plan 2/3 choice for new hires, on the other hand, is the type of benefit that has been approved in many other 401(a) plans, and is not viewed as problematic for the IRS in its own right.

Removal of contribution rate flexibility will not only eliminate IRS uncertainty, but it will also contribute to consistency among the plans, as this provision has been implemented in TRS but not in PERS or SERS. On the other hand, if the IRS approves member contribution rate flexibility for all the Plans 3, this element of the proposal would remove a significant benefit from the Plans 3.

Plan 3 Gain-Sharing

This final element of the proposal is the most complex from a policy perspective, and has implications for the entire tradeoff package. The proposal would eliminate Plan 3 gain-sharing for members of PERS and TRS, and would amend gain-sharing for SERS to provide a definite annual contribution into the Plan 3 member accounts. The entire benefit package identified in this proposal (including the modified rule of 90 and Plan 2/3 choice) is viewed as the tradeoff for the Plan 3 gain-sharing provisions in current law.

<u>"No Contractual Right" Clause</u>

The gain-sharing provisions in current law are subject to a "no contractual right" or "reservation" clause. This clause states that "no member or beneficiary has a contractual right to receive this distribution...." These kinds of clauses in plan provisions of the Washington State Retirement Systems have not been tested in the courts. This legal uncertainty lends an aspect of unpredictability to a benefit that is already unpredictable due to market volatility.

Recently the Attorney General's Office provided informal advice that is relevant to whether gain-sharing could be repealed or amended and replaced with other benefits that are more certain. This advice was summarized to the Purchasing Power subgroup as follows:

1. There isn't a clear answer to whether gain-sharing is a vested, contractual right. It might not be a vested, contractual right because of the reservation clause.

2. If the court believes gain-sharing is a vested, contractual right, it is more likely than not that a court would find the right has not been substantially impaired because members and beneficiaries were "put on notice" that the legislature may amend or repeal gain-sharing in the future (via the reservation clause).

3. With regard to comparable benefits, if gain-sharing were repealed and replaced by another benefit, courts favor comparable benefits which are similar to the old benefit.

4. Under the context of gain-sharing, it is reasonable to adjust the value of an uncertain and unpredictable benefit when determining the value of a comparable replacement which has little or no uncertainty.

Trading Uncertainty for Certainty

Having received this informal advice, the Purchasing Power subgroup instructed staff to develop a tradeoff package with a target cost that would be approximately one-half of the forecasted cost of future gain-sharing. However this "tradeoff value" approach is not as simple for the Plans 3 as it was for the Plans 1. This is due largely to the fact that the Plans 1 are closed plans and the Plans 3 are not. The cost of future gain-sharing benefits is figured on a closed group valuation, that is the Plans 3 as of a certain date. In reality, the Plans 3 are not closed. Theoretically, lawmakers would trade a closed group liability for a closed group benefit, i.e. one that doesn't involve future hires. In practice, however, such an approach would lead to further inconsistencies between the retirement systems and additional administrative complexity.

Trading-Off Similar Benefits

The existing Plan 3 gain-sharing benefits involve direct contributions into the Plan 3 accounts of active, retired and term-vested members. These gain-sharing benefits are being traded in part for benefits related to retirement eligibility and plan choice that do not benefit current retirees or term-vested members in TRS and PERS. Also, in terms of the nature of the benefits being traded, the replacement benefits are not the same as those set forth in the gain-sharing chapter. Still, they are retirement benefits (as opposed to health insurance benefits or other non-pension benefits). The SERS 3 benefit retained in the trade-off package is the most comparable to the original gain-sharing provisions.

Parity Among the Plans

As mentioned above, the SERS 3 provision was included because SERS 3 members get the least benefit of the three systems from a Rule of 90, and the provision would help provide more balance in the gain-sharing tradeoff for all plan 3 members. As can be seen in the draft fiscal note, the tradeoff package approximates forty-two percent (42%) of the expected long-term employer liability for gain-sharing for the three systems in total, but the cost varies by individual retirement system. The PERS cost is above the target cost of 50%, the TRS cost is below it, and the SERS cost is right at the 50% target.

Trading-off Plan 3 Benefits for Plan 2/3 Benefits

It should also be noted that Plan 2 members receive a benefit as part of the Plan 3 gain-sharing tradeoff package, yet they do not participate in gain-sharing. This aspect of the proposal may, however, help to address a past inconsistency. As pointed out in the August 30, 2004 Revised Gain-Sharing Report, Plan 2 members were left out of the original gain-sharing provisions. While Plan 2 members have been able to participate in past gains by having lower contribution rates, they are also required to participate in offsetting losses by having their contribution rate's increase. Thus, overall, no benefits were given to Plan 2 members via the gain-sharing provisions. On the other hand, Plan 1 and Plan 3 members participate in gains by getting permanent benefit increases. They do not, however, pay for offsetting losses as their member contribution rates are fixed.

Still, if the primary purpose of the tradeoff package is to replace gain-sharing with a more certain Plan 3 benefit, and gain-sharing does not apply to the Plans 2, it may not make sense to include a benefit in the proposal that enhances the Plans 2. Also, if the intent is for future employees to move to the Plan 3 hybrid pension model, then again, the proposal may be inconsistent with this policy, as it enhances Plan 2 benefits and would result in more new entrants into the Plans 2.

Administrative Impacts

On December 3, 2004, DRS Director John Charles indicated that there are no significant barriers to implementation, but an administrative fiscal note would be prepared on any final legislative proposal.

Bill (Draft)

The bill draft for this proposal is provided as a handout at the December 7, 2004 meeting.

Fiscal Note (Draft)

The draft fiscal note for this proposal is provided as a handout at the December 7, 2004 meeting.

AN ACT Relating to amending and replacing plan 3 gain-sharing provisions with prospective unreduced retirement benefits in plans 2 and 3 of the public employees' retirement system, the teachers' retirement system, and the school employees' retirement system; with a ninety-day window for new members of the teachers' retirement system and the school employees' retirement system to make a choice between plan 2 and plan 3; and with an annual employer contribution into the plan 3 member accounts of the school employees' retirement system; amending RCW 41.40.630, 41.40.820, 41.32.765, 41.32.875, 41.35.420, 41.35.680, 41.32.835, 41.35.610, 41.31A.010, 41.31A.020, 41.45.061, and 41.34.040; decodifying RCW 41.31A.030 and 41.31A.040; and providing an effective date.

BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF WASHINGTON:

Sec. 1. RCW 41.40.630 and 2000 c 247 s 901 are each amended to read as follows:

(1) NORMAL RETIREMENT. Any member with at least five service credit years who has attained at least age sixty-five shall be eligible to retire and to receive a retirement allowance computed according to the provisions of RCW 41.40.620.

(2) UNREDUCED RETIREMENT. Any member who has completed at least five service credit years and has attained age sixty, and for whom the sum of the number of years of the member's age and the number of years of the member's service credit equals ninety or more, shall be eligible to retire. For the portion of the member's benefit that is based on service credit earned after July 1, 2007, the member shall receive an unreduced retirement allowance computed according to the provisions of RCW 41.40.620. For the portion of the member's benefit that is based on service credit earned prior to July 1, 2007, the retirement allowance shall be reduced under subsection (3) or (4) of this section as applicable.

(3) EARLY RETIREMENT. Any member who has completed at least twenty service credit years and has attained age fifty-five shall be eligible to retire and to receive a retirement allowance computed according to the provisions of RCW 41.40.620, except that a member retiring pursuant to this subsection shall have the retirement allowance actuarially reduced to reflect the difference in the number of years between age at retirement and the attainment of age sixty-five.

((~~(3)~~)) (4) ALTERNATE EARLY RETIREMENT. Any member who has completed at least thirty service credit years and has attained age fifty-five shall be eligible to retire and to receive a retirement allowance computed according to the provisions of RCW 41.40.620, except that a member retiring pursuant to this subsection shall have the retirement allowance reduced by three percent per year to reflect the difference in the number of years between age at retirement and the attainment of age sixty-five.

Sec. 2. RCW 41.40.820 and 2000 c 247 s 309 are each amended to read as follows:

(1) NORMAL RETIREMENT. Any member who is at least age sixty-five and who has:

(a) Completed ten service credit years; or

(b) Completed five service credit years, including twelve service credit months after attaining age fifty-four; or

(c) Completed five service credit years by the transfer payment date specified in RCW 41.40.795, under the public employees' retirement system plan 2 and who transferred to plan 3 under RCW 41.40.795;

shall be eligible to retire and to receive a retirement allowance computed according to the provisions of RCW 41.40.790.

(2) UNREDUCED RETIREMENT. Any member who has completed the number of service credit years required in subsection (1) of this section and has attained age sixty, and for whom the sum of the number of years of the member's age and the number of years of the member's service credit equals ninety or more, shall be eligible to retire. For the portion of the member's benefit that is based on service credit earned after July 1, 2007, the member shall receive an unreduced retirement allowance computed according to the provisions of RCW 41.40.790. For the portion of the member's benefit that is based on service credit earned prior to July 1, 2007, the retirement allowance shall be reduced under subsection (3) or (4) of this section as applicable.

(3) EARLY RETIREMENT. Any member who has attained at least age fifty-five and has completed at least ten years of service shall be eligible to retire and to receive a retirement allowance computed according to the provisions of RCW 41.40.790, except that a member retiring pursuant to this subsection shall have the retirement allowance actuarially reduced to reflect the difference in the number of years between age at retirement and the attainment of age sixty-five.

((~~(3)~~)) (4) ALTERNATE EARLY RETIREMENT. Any member who has completed at least thirty service credit years and has attained age fifty-five shall be eligible to retire and to receive a retirement allowance computed according to the provisions of RCW 41.40.790, except that a member retiring pursuant to this subsection shall have the retirement allowance reduced by three percent per year to reflect the difference in the number of years between age at retirement and the attainment of age sixty-five.

Sec. 3. RCW 41.32.765 and 2000 c 247 s 902 are each amended to read as follows:

(1) NORMAL RETIREMENT. Any member with at least five service credit years of service who has attained at least age sixty-five shall be eligible to retire and to receive a retirement allowance computed according to the provisions of RCW 41.32.760.

(2) UNREDUCED RETIREMENT. Any member who has completed at least five service credit years and has attained age sixty, and for whom the

sum of the number of years of the member's age and the number of years of the member's service credit equals ninety or more, shall be eligible to retire. For the portion of the member's benefit that is based on service credit earned after July 1, 2007, the member shall receive an unreduced retirement allowance computed according to the provisions of RCW 41.32.760. For the portion of the member's benefit that is based on service credit earned prior to July 1, 2007, the retirement allowance shall be reduced under subsection (3) or (4) of this section as applicable.

(3) EARLY RETIREMENT. Any member who has completed at least twenty service credit years of service who has attained at least age fifty-five shall be eligible to retire and to receive a retirement allowance computed according to the provisions of RCW 41.32.760, except that a member retiring pursuant to this subsection shall have the retirement allowance actuarially reduced to reflect the difference in the number of years between age at retirement and the attainment of age sixty-five.

((~~(3)~~)) (4) ALTERNATE EARLY RETIREMENT. Any member who has completed at least thirty service credit years and has attained age fifty-five shall be eligible to retire and to receive a retirement allowance computed according to the provisions of RCW 41.32.760, except that a member retiring pursuant to this subsection shall have the retirement allowance reduced by three percent per year to reflect the difference in the number of years between age at retirement and the attainment of age sixty-five.

Sec. 4. RCW 41.32.875 and 2000 c 247 s 903 are each amended to read as follows:

(1) NORMAL RETIREMENT. Any member who is at least age sixty-five and who has:

(a) Completed ten service credit years; or

(b) Completed five service credit years, including twelve service credit months after attaining age fifty-four; or

(c) Completed five service credit years by July 1, 1996, under plan 2 and who transferred to plan 3 under RCW 41.32.817;

shall be eligible to retire and to receive a retirement allowance computed according to the provisions of RCW 41.32.840.

(2) UNREDUCED RETIREMENT. Any member who has completed the number of service credit years required in subsection (1) of this section and has attained age sixty, and for whom the sum of the number of years of the member's age and the number of years of the member's service credit equals ninety or more, shall be eligible to retire. For the portion of the member's benefit that is based on service credit earned after July 1, 2007, the member shall receive an unreduced retirement allowance computed according to the provisions of RCW 41.32.840. For the portion of the member's benefit that is based on service credit earned prior to July 1, 2007, the retirement allowance shall be reduced under subsection (3) or (4) of this section as applicable.

(3) EARLY RETIREMENT. Any member who has attained at least age fifty-five and has completed at least ten years of service shall be eligible to retire and to receive a retirement allowance computed according to the provisions of RCW 41.32.840, except that a member retiring pursuant to this subsection shall have the retirement allowance actuarially reduced to reflect the difference in the number of years between age at retirement and the attainment of age sixty-five.

((~~(3)~~)) (4) ALTERNATE EARLY RETIREMENT. Any member who has completed at least thirty service credit years and has attained age fifty-five shall be eligible to retire and to receive a retirement allowance computed according to the provisions of RCW 41.32.840, except that a member retiring pursuant to this subsection shall have the retirement allowance reduced by three percent per year to reflect the difference in the number of years between age at retirement and the attainment of age sixty-five.

Sec. 5. RCW 41.35.420 and 2000 c 247 s 905 are each amended to read as follows:

(1) NORMAL RETIREMENT. Any member with at least five service credit years who has attained at least age sixty-five shall be eligible to retire and to receive a retirement allowance computed according to the provisions of RCW 41.35.400.

(2) UNREDUCED RETIREMENT. Any member who has completed at least five service credit years and has attained age sixty, and for whom the sum of the number of years of the member's age and the number of years of the member's service credit equals ninety or more, shall be eligible

to retire. For the portion of the member's benefit that is based on service credit earned after July 1, 2007, the member shall receive an unreduced retirement allowance computed according to the provisions of RCW 41.35.400. For the portion of the member's benefit that is based on service credit earned prior to July 1, 2007, the retirement allowance shall be reduced under subsection (3) or (4) of this section as applicable.

(3) EARLY RETIREMENT. Any member who has completed at least twenty service credit years and has attained age fifty-five shall be eligible to retire and to receive a retirement allowance computed according to the provisions of RCW 41.35.400, except that a member retiring pursuant to this subsection shall have the retirement allowance actuarially reduced to reflect the difference in the number of years between age at retirement and the attainment of age sixty-five.

((~~(3)~~)) (4) ALTERNATE EARLY RETIREMENT. Any member who has completed at least thirty service credit years and has attained age fifty-five shall be eligible to retire and to receive a retirement allowance computed according to the provisions of RCW 41.35.400, except that a member retiring pursuant to this subsection shall have the retirement allowance reduced by three percent per year to reflect the difference in the number of years between age at retirement and the attainment of age sixty-five.

Sec. 6. RCW 41.35.680 and 2000 c 247 s 906 are each amended to read as follows:

(1) NORMAL RETIREMENT. Any member who is at least age sixty-five and who has:

(a) Completed ten service credit years; or

(b) Completed five service credit years, including twelve service credit months after attaining age fifty-four; or

(c) Completed five service credit years by September 1, 2000, under the public employees' retirement system plan 2 and who transferred to plan 3 under RCW 41.35.510;

shall be eligible to retire and to receive a retirement allowance computed according to the provisions of RCW 41.35.620.

(2) UNREDUCED RETIREMENT. Any member who has completed the number of service credit years required in subsection (1) of this section and has attained age sixty, and for whom the sum of the number of years of

the member's age and the number of years of the member's service credit equals ninety or more, shall be eligible to retire. For the portion of the member's benefit that is based on service credit earned after July 1, 2007, the member shall receive an unreduced retirement allowance computed according to the provisions of RCW 41.35.620. For the portion of the member's benefit that is based on service credit earned prior to July 1, 2007, the retirement allowance shall be reduced under subsection (3) or (4) of this section as applicable.

(3) EARLY RETIREMENT. Any member who has attained at least age fifty-five and has completed at least ten years of service shall be eligible to retire and to receive a retirement allowance computed according to the provisions of RCW 41.35.620, except that a member retiring pursuant to this subsection shall have the retirement allowance actuarially reduced to reflect the difference in the number of years between age at retirement and the attainment of age sixty-five.

((~~(3)~~)) (4) ALTERNATE EARLY RETIREMENT. Any member who has completed at least thirty service credit years and has attained age fifty-five shall be eligible to retire and to receive a retirement allowance computed according to the provisions of RCW 41.35.620, except that a member retiring pursuant to this subsection shall have the retirement allowance reduced by three percent per year to reflect the difference in the number of years between age at retirement and the attainment of age sixty-five.

Sec. 7. RCW 41.32.835 and 1995 c 239 s 105 are each amended to read as follows:

(1) All teachers who first become employed by an employer in an eligible position on or after ((~~July 1, 1996, shall be members of plan 3~~)) July 1, 2007, shall have a period of ninety days to make an irrevocable choice to become a member of plan 2 or plan 3. At the end of ninety days, if the member has not made a choice to become a member of plan 2, he or she becomes a member of plan 3.

(2) For administrative efficiency, until a member elects to become a member of plan 3, or becomes a member of plan 3 by default under subsection (1) of this section, the member shall be reported to the department in plan 2, with member and employer contributions. Upon becoming a member of plan 3 by election or by default, all service

credit shall be transferred to the member's plan 3 defined benefit, and all employee accumulated contributions shall be transferred to the member's plan 3 defined contribution account.

Sec. 8. RCW 41.35.610 and 1998 c 341 s 202 are each amended to read as follows:

(1) All classified employees who first become employed by an employer in an eligible position on or after ((~~September 1, 2000, shall be members of plan 3~~)) July 1, 2007, shall have a period of ninety days to make an irrevocable choice to become a member of plan 2 or plan 3. At the end of ninety days, if the member has not made a choice to become a member of plan 2, he or she becomes a member of plan 3.

(2) For administrative efficiency, until a member elects to become a member of plan 3, or becomes a member of plan 3 by default under subsection (1) of this section, the member shall be reported to the department in plan 2, with member and employer contributions. Upon becoming a member of plan 3 by election or by default, all service credit shall be transferred to the member's plan 3 defined benefit, and all employee accumulated contributions shall be transferred to the member's plan 3 defined contribution account.

Sec. 9. RCW 41.31A.010 and 2000 c 247 s 407 are each amended to read as follows:

The definitions in this section apply throughout this chapter unless the context requires otherwise.

(1) "Actuary" means the state actuary or the office of the state actuary.

(2) "Department" means the department of retirement systems.

(3) ((~~"Teacher" means any employee included in the membership of the teachers' retirement system as provided for in chapter 41.32 RCW.~~

~~(4)~~)) "Member account" or "member's account" means the sum of any contributions as provided for in chapter 41.34 RCW and the earnings on behalf of the member.

((~~(5)~~)) (4) "Classified employee" means the same as in RCW 41.35.010.

((~~(6) "Public employee" means the same as "member" as defined in RCW 41.40.010(5).~~))

(5) "Terminated vested member" means a member who separates or has separated from service after having completed enough service credit years to be vested in the defined benefit portion of the members' plan and who remains a member during the period of absence from service for the exclusive purpose of receiving a future retirement allowance.

Sec. 10. RCW 41.31A.020 and 2003 c 294 s 4 are each amended to read as follows:

(1) On January 1, ((~~2004~~)) 2008, and on January 1st of ((~~even-numbered years~~)) each year thereafter, the member account of a person meeting the requirements of this section shall be credited by the extraordinary investment gain amount.

(2) ((~~The following persons~~)) Members, retirees, and terminated vested members of the school employees' retirement system plan 3 as of June 30, 2007, who also meet the criteria in any of (a) through (f) of this subsection shall be eligible for the benefit provided in subsection (1) of this section:

(a) Any member of the ((~~teachers' retirement system plan 3, the~~)) Washington school employees' retirement system plan 3((~~, or the public employees' retirement system plan 3~~)) who earned service credit during the twelve-month period from September 1st to August 31st immediately preceding the distribution and had a balance of at least one thousand dollars in their member account on August 31st of the year immediately preceding the distribution; or

(b) Any person in receipt of a benefit pursuant to RCW ((~~41.32.875,~~)) 41.35.680((~~, or 41.40.820~~)); or

(c) Any person who is a retiree pursuant to RCW 41.34.020(8) and who:

(i) Completed ten service credit years; or

(ii) Completed five service credit years, including twelve service months after attaining age fifty-four; or

(d) ((~~Any teacher who is a retiree pursuant to RCW 41.34.020(8) and who has completed five service credit years by July 1, 1996, under plan 2 and who transferred to plan 3 under RCW 41.32.817; or~~

~~(e)~~)) Any classified employee who is a retiree pursuant to RCW 41.34.020(8) and who has completed five service credit years by September 1, 2000, and who transferred to plan 3 under RCW 41.35.510; or

((~~(f) Any public employee who is a retiree pursuant to RCW 41.34.020(8) and who has completed five service credit years by March 1, 2002, and who transferred to plan 3 under RCW 41.40.795; or~~

~~(g)~~)) (e) Any person who had a balance of at least one thousand dollars in their member account on August 31st of the year immediately preceding the distribution and who:

(i) Completed ten service credit years; or

(ii) Completed five service credit years, including twelve service months after attaining age fifty-four; or

((~~(h) Any teacher who had a balance of at least one thousand dollars in their member account on August 31st of the year immediately preceding the distribution and who has completed five service credit years by July 1, 1996, under plan 2 and who transferred to plan 3 under RCW 41.32.817; or~~

~~(i)~~)) (f) Any classified employee who had a balance of at least one thousand dollars in their member account on August 31st of the year immediately preceding the distribution and who has completed five service credit years by September 1, 2000, and who transferred to plan 3 under RCW 41.35.510((~~; or~~

~~(j) Any public employee who had a balance of at least one thousand dollars in their member account on August 31st of the year immediately preceding the distribution and who has completed five service credit years by March 1, 2002, and who transferred to plan 3 under RCW 41.40.795~~)).

(3) The extraordinary investment gain amount shall be calculated as follows:

((~~(a) One-half of the sum of the value of the net assets held in trust for pension benefits in the teachers' retirement system combined plan 2 and 3 fund, the Washington school employees' retirement system combined plan 2 and 3 fund, and the public employees' retirement system combined plan 2 and 3 fund at the close of the previous state fiscal year not including the amount attributable to member accounts;~~

~~(b) Multiplied by the amount which the compound average of investment returns on those assets over the previous four state fiscal years exceeds ten percent;~~

~~(c) Multiplied by the proportion of:~~

~~(i) The sum of the service credit on August 31st of the previous~~

~~year of all persons eligible for the benefit provided in subsection (1) of this section; to~~

~~(ii) The sum of the service credit on August 31st of the previous year of:~~

~~(A) All persons eligible for the benefit provided in subsection (1) of this section;~~

~~(B) Any person who earned service credit in the teachers' retirement system plan 2, the Washington school employees' retirement system plan 2, or the public employees' retirement system plan 2 during the twelve-month period from September 1st to August 31st immediately preceding the distribution;~~

~~(C) Any person in receipt of a benefit pursuant to RCW 41.32.765, 41.35.420, or 41.40.630; and~~

~~(D) Any person with five or more years of service in the teachers' retirement system plan 2, the Washington school employees' retirement system plan 2, or the public employees' retirement system plan 2;~~

~~(d) Divided proportionally among persons eligible for the benefit provided in subsection (1) of this section on the basis of their~~)) Ten dollars, which shall be increased by three percent per year rounded to the nearest cent, multiplied by the member's service credit total on August 31st of the previous year.

((~~(4) The legislature reserves the right to amend or repeal this section in the future and no member or beneficiary has a contractual right to receive this distribution not granted prior to that time.~~))

NEW SECTION. **Sec. 11.** RCW 41.31A.030 is decodified.

NEW SECTION. **Sec. 12.** RCW 41.31A.040 is decodified.

Sec. 13. RCW 41.45.061 and 2004 c 242 s 40 are each amended to read as follows:

(1) The required contribution rate for members of the ((~~plan 2~~)) teachers' retirement system plan 2 shall be ((~~fixed at the rates in effect on July 1, 1996, subject to the following:~~

~~(a) Beginning September 1, 1997, except as provided in (b) of this subsection, the employee contribution rate shall not exceed the employer plan 2 and 3 rates adopted under RCW 41.45.060, 41.45.054, and 41.45.070 for the teachers' retirement system;~~

~~(b) In addition, the employee contribution rate for plan 2 shall be increased by fifty percent of the contribution rate increase caused by any plan 2 benefit increase passed after July 1, 1996;~~

~~(c) In addition, the employee contribution rate for plan 2 shall not be increased as a result of any distributions pursuant to section 309, chapter 341, Laws of 1998 and RCW 41.31A.020~~)) set at the same rate as the employer combined plan 2 and plan 3 rate.

(2) The required contribution rate for members of the school employees' retirement system plan 2 shall ((~~equal the school employees' retirement system employer plan 2 and 3 contribution rate adopted under RCW 41.45.060, 41.45.054, and 41.45.070, except as provided in subsection (3) of this section.~~

~~(3) The member contribution rate for the school employees' retirement system plan 2 shall be increased by fifty percent of the contribution rate increase caused by any plan 2 benefit increase passed after September 1, 2000~~)) be set at the same rate as the employer combined plan 2 and plan 3 rate.

((~~(4)~~)) (3) The required contribution rate for members of the public employees' retirement system plan 2 shall be set at the same rate as the employer combined plan 2 and plan 3 rate.

((~~(5)~~)) (4) The required contribution rate for members of the law enforcement officers' and fire fighters' retirement system plan 2 shall be set at fifty percent of the cost of the retirement system.

((~~(6)~~)) (5) The ((~~employee~~)) required contribution rates for members of the school employees' retirement system plan 2 ((~~under subsections (3) and (4) of this section~~)) shall not include any increase as a result of any distributions pursuant to RCW 41.31A.020 ((~~and 41.31A.030~~)).

((~~(7)~~)) (6) The required plan 2 and 3 contribution rates for employers shall be adopted in the manner described in RCW 41.45.060, 41.45.054, and 41.45.070.

((~~(8)~~)) (7) The required contribution rate for members of the public safety employees' retirement system plan 2 shall be set at fifty percent of the cost of the retirement system.

Sec. 14. RCW 41.34.040 and 2003 c 156 s 1 are each amended to read as follows:

(1) A member shall contribute from his or her compensation according to one of the following rate structures in addition to the mandatory minimum five percent:

<u>Option A</u>	<u>Contribution Rate</u>
All Ages	0.0% fixed
<u>Option B</u>	
Up to Age 35	0.0%
Age 35 to 44	1.0%
Age 45 and above	2.5%
<u>Option C</u>	
Up to Age 35	1.0%
Age 35 to 44	2.5%
Age 45 and above	3.5%
<u>Option D</u>	
All Ages	2.0%
<u>Option E</u>	
All Ages	5.0%
<u>Option F</u>	
All Ages	10.0%

(2) The board shall have the right to offer contribution rate options in addition to those listed in subsection (1) of this section, provided that no significant additional administrative costs are created. All options offered by the board shall conform to the requirements stated in subsections (3) and (5) of this section.

(3)(a) For members of the teachers' retirement system entering plan 3 under RCW 41.32.835 or members of the school employees' retirement system entering plan 3 under RCW 41.35.610, within ninety days of becoming a member he or she has an option to choose one of the above contribution rate structures. If the member does not select an option within the ninety-day period, he or she shall be assigned option A.

(b) For members of the public employees' retirement system entering plan 3 under RCW 41.40.785, within the ninety days described in RCW 41.40.785 an employee who irrevocably chooses plan 3 shall select one of the above contribution rate structures. If the member does not select an option within the ninety-day period, he or she shall be assigned option A.

(c) For members of the teachers' retirement system transferring to plan 3 under RCW 41.32.817, members of the school employees' retirement system transferring to plan 3 under RCW 41.35.510, or members of the public employees' retirement system transferring to plan 3 under RCW 41.40.795, upon election to plan 3 he or she must choose one of the above contribution rate structures.

(d) Within ninety days of the date that an employee changes employers, he or she has an option to choose one of the above contribution rate structures. If the member does not select an option within this ninety-day period, he or she shall be assigned option A.

(4) ((~~Each year, members may change their contribution rate option by notifying their employer in writing during the month of January.~~

~~(5)~~)) Contributions shall begin the first day of the pay cycle in which the rate option is made, or the first day of the pay cycle in which the end of the ninety-day period occurs.

<u>NEW SECTION.</u> **Sec. 15.** The benefits provided pursuant to this act are not provided to employees as a matter of contractual right prior to July 1, 2007. The legislature retains the right to alter or abolish these benefits at any time prior to July 1, 2007.

<u>NEW SECTION.</u> **Sec. 16.** Except for section 15 of this act, this act takes effect July 1, 2007.

--- END ---

DRAFT FISCAL NOTE

REQUEST NO.

RESPONDING AGENCY:	CODE:	DATE:	BILL NUMBER:
Office of the State Actuary	**035**	**12/21/04**	**Z-0243.1/Z-0259.1**

SUMMARY OF BILL:

This bill impacts the Plans 2 and 3 of the teachers' retirement system (TRS), the school employees' retirement system (SERS) and the public employees' retirement system (PERS). The bill eliminates Plan 3 gain-sharing for TRS and PERS. Existing Plan 3 gain-sharing provisions would be replaced with a rule of 90 that uses an age 60 minimum, and that has unreduced benefits for prospective service only in TRS 2/3, SERS 2/3 and PERS 2/3. In addition, Plan 2/3 choice would be added for new hires in TRS and SERS (same structure for choice as in PERS). The proposed legislation amends Plan 3 gain-sharing for SERS by providing an annual contribution to the defined contribution accounts of existing SERS 3 members. The SERS 3 contribution would be $10 times years of service.

The trade-off package also removes the Plan 3 provision that allows members to change their employee contribution rate by notifying their employer in writing during the month of January. The bill also amends the section of the actuarial funding chapter addressing employee contributions in order to make it consistent with the changes to gain-sharing.

Effective Date: July 1, 2007

CURRENT SITUATION:

Currently, Plan 2/3 members of TRS, SERS and PERS are eligible to retire with unreduced benefits when they are vested and reach age 65. The vesting period for the Plans 2 is five years. The vesting period for the defined benefit component of the Plans 3 is ten years, or 5 years if 12 months of service were accrued after attaining age 54. (Plan 3 members are immediately vested in the defined contribution portion of their benefit, and Plan 3 members are vested if they were vested in Plan 2 when they transferred.)

Currently, of the three systems, PERS is the only one that has Plan 2/3 choice. New PERS employees have a period of ninety days to make an irrevocable choice to become a member of Plan 2 or Plan 3. At the end of ninety days, if the member has not made a choice to become a member of Plan 2, he or she automatically becomes a member of Plan 3. In TRS and SERS, new employees automatically become members of Plan 3, and the Plans 2 are closed to new hires.

Current law provides that members of the Plans 3 may change their contribution rate option by notifying their employer in writing during the month of January. In practice, this provision is only available to TRS 3 members, as the IRS has not yet approved contribution rate flexibility for PERS and SERS. An application for IRS approval has been pending for approximately 2.5 years.

Currently, gain-sharing applies to the Plans 1 and 3 of TRS, SERS and PERS. Gain-sharing is a mechanism that increases benefits. The increases are not automatic, but are contingent on the occurrence of "extraordinary investment gains." Extraordinary gains occur when the compound average of investment returns on pension fund assets exceeds 10% for the previous four state fiscal years. When this occurs, a calculation is performed to determine a dollar amount that will be distributed to eligible members. Gain-sharing calculations are currently made once each biennium with potential distributions occurring in January of even-numbered years. In the Plans 3, active, retired and terminated vested members receive distributions as a lump sum dollar amount that is deposited directly into their defined contribution accounts based on years of service credit. There have been two gain-sharing distributions since the inception of gain-sharing: one in 1998 and one in 2000.

MEMBERS IMPACTED:

The repeal of Plan 3 gain sharing for PERS and TRS and the modification of Plan 3 gain sharing for SERS could potentially impact all current and future members of PERS 3, TRS 3, and SERS 3, including all of the active Plan 3 members except those that would not meet the requirement of having a minimum $1,000 balance in the member account, all of the Plan 3 annuitants, all of the Plan 3 terminated vested members meeting the minimum balance requirement, and any Plan 3 terminated non-vested members who are rehired.

(As of September 30, 2003)	**PERS 3**	**TRS 3**	**SERS 3**
Active	17,548	47,263	27,710
Annuitants	86	385	306
Terminated and Vested	770	2,418	1,648
Total	18,404	50,066	29,664

Rule of 90 Benefit

	PERS 2	**PERS 3**	**TRS 2**	**TRS 3**	**SERS 2**	**SERS 3**
Number of Affected Active	82,259	13,497	5,209	37,310	12,455	16,167
Total Active Members	117,262	17,548	7,637	47,263	21,504	27,710

Regarding the Plan 2 /3 choice, this will impact TRS and SERS members hired on or after July 1, 2007. We estimate that from October 1, 2007 to September 30, 2008, there will be a total of 4,492 new TRS members and 5,384 new SERS members. The number of new members is expected to increase each year. We estimate that 50% of these new members would elect to join Plan 2 and 50% would elect Plan 3.

Regarding the SERS contribution, this will impact 29,664 members of SERS 3, including 27,710 active SERS 3 members, 306 SERS 3 annuitants, and 1,648 SERS 3 terminated vested members. This is the same as the number of SERS 3 members impacted by the repeal of gain sharing. The only difference is that to receive the contribution at any time in the future, a member would need to meet the eligibility requirements on the effective date of the act and the eligibility requirements on the effective date of a future distribution.

Regarding the removal of the Plan 3 provision that allows members to change their employee contribution rate by notifying their employer in writing during the month of January, this would impact 17,548 active PERS 3 members, 47,263 active TRS 3 members, and 27,710 active SERS 3 members.

For a member impacted by the Rule of 90 portion of the bill, the increase in benefits would be the removal of benefit reduction for early retirement without the Rule of 90 for service accrued after the effective date of the act. For example, a member hired after the effective date retiring at age 60 with 30 years of service would be entitled to an unreduced benefit instead of a benefit with a 15% reduction. A member age 45 with 15 years of service as of the effective date retiring at age 60 with 30 years of service would be entitled to a benefit with a 7.5% reduction instead of a benefit with a 15% reduction (one-half of the 15% reduction, since 15 years out of 30, or one-half, of the service would have been credited before the effective date).

Regarding the $10 SERS 3 contribution, the $10 multiplier would increase at 3% per year and the contribution amount would increase for each additional year of service. The typical SERS 3 member would receive a benefit with a present value of $2,200. A SERS 3 member with 11 years of service would receive an employer contribution of $110 the first year, and if the member remained employed by SERS, the member would receive $124 the second year and $544 the twentieth year. The amount would continue to be deposited to the member's account for life, or until termination of employment if the member is non-vested.

Regarding the removal of the Plan 3 provision that allows members to change their employee contribution rate by notifying their employer in writing during the month of January, this would impact the defined contribution portion of the plan and would have no impact on benefits under the defined benefit plan.

ASSUMPTIONS:

We assumed that employer contribution rates would decrease after the proposed repeal of Plan 3 gain sharing because we started with rates that included the cost of future gain-sharing benefits. The cost impact was developed using the same logic as used for the valuation (rates were determined assuming a delayed effective date).

For pricing the Rule of 90 portion of the bill, we assumed that there would be an increase in retirement rates due to the Rule of 90. The additional rates or "kickers" are provided at the end of this fiscal note. The additional rates at age 60 are higher to reflect the pent-up demand for the benefit from the members who satisfy the rule of 90 before the minimum age of 60. Since the portion of the benefit without reduction for early commencement would apply to prospective service only, we determined the price of this benefit using the increase in the Entry Age Normal Cost rate (EANC) for current members and for new entrants.

For pricing the cost of choice, we determined the Entry Age Normal Cost rate (EANC) for Plan 2 as if every active Plan 2 and Plan 3 member were in Plan 2, and we determined the EANC for Plan 3 as if every active Plan 2 and Plan 3 member were in Plan 3. We calculated the excess of the employer portion of the EANC for Plan 2 over the EANC for Plan 3 and then took 50% of the difference to reflect our assumption that 50% of new members in TRS and SERS would elect to join Plan 2 and 50% would elect Plan 3. Since the choice would only apply to new members, we assumed no rate increase for choice for the current members, and applied the rate increase for choice to the projected payroll for the new members only.

We considered making an adjustment for the cost of choice based on the age of members who would elect Plan 2 compared to the age of members who would elect Plan 3, however, after reviewing the choices made by new members in PERS over an 18-month period, there was no significant difference in choice based on age.

For the SERS 3 contribution, we projected the total years of credited service for SERS 3 members, active and inactive, multiplied the service by the indexed benefit, and took the present value at 8%.

FISCAL IMPACT:

Description:

The decrease in contribution rates from the proposed repeal of future Plan 3 gain sharing is partially offset by the increase due to the proposed benefit improvements.

Actuarial Determinations:

The bill will impact the actuarial funding of the system by increasing the present value of benefits payable under the System (for existing members impacted by this bill) and the required actuarial contribution rate as shown below:

(Dollars in Millions)		**Current**	**Increase**	**Total**
Actuarial Present Value of Projected Benefits	**PERS 2/3**	$14,278	$41	$14,319
(The Value of the Total Commitment to all Current Members)	**TRS 2/3**	$5,220	$(236)	$4,984
	SERS 2/3	$2,138	$(73)	$2,065
Unfunded Actuarial Accrued Liability	**PERS 1**	$2,620	$3	$2,623
(The Portion of the Plan 1 Liability that is Amortized at 2024)	**TRS 1**	$1,416	$16	$1,432
Unfunded Liability (PBO)	**PERS 2/3**	$(3,184)	$34	$(3,150)
(The Value of the Total Commitment to all Current Members Attributable to Past Service)	**TRS 2/3**	$(1,397)	$(84)	$(1,481)
	SERS 2/3	$(425)	$(25)	$(450)

Increase in Contribution Rates:

	PERS	TRS	SERS
Employee (Effective 9/1/2005 unless indicated otherwise)			
Repeal Gain Sharing (effective 7/1/2005 for PERS)	0.00%	0.00%	0.00%
Modified Rule of 90	0.18%	0.34%	0.17%
Plan 2/3 Choice	0.00%	0.00%	0.00%
SERS 3 Contribution	0.00%	0.00%	0.00%
Total Benefit Improvements	0.18%	0.34%	0.17%
Net Employee (Plan 2)	0.18%	0.34%	0.17%
Employer State (Effective 9/1/2005 unless indicated otherwise			
Repeal Gain Sharing (effective 7/1/2005 for PERS)	-0.25%	-1.17%	-1.95%
Modified Rule of 90	0.18%	0.33%	0.17%
Plan 2/3 Choice*	0.00%	0.00%	0.00%
SERS 3 Contribution	0.00%	0.00%	0.81%
Total Benefit Improvements	0.18%	0.33%	0.98%
Net Employer State	-0.07%	-0.84%	-0.97%

The TRS Employer rate change of (1.17%) for the repeal of gain sharing is made up of a normal cost rate change of (1.21%) plus a change in the Plan 1 UAAL rate of 0.04%.

The TRS Employer rate change of 0.33% for the benefit improvements is made up of a normal cost rate change of 0.34% plus a change in the Plan 1 UAAL rate of (0.01%).

The net TRS Employer rate change of (0.84%) is made up of a normal cost rate change of (0.87%) plus a change in the Plan 1 UAAL rate of 0.03%.

**There is no impact on employer contribution rates for choice on behalf of existing members. A 0.14% increase for TRS and 0.16% increase for SERS is anticipated for future new entrants and reflected under the projected funding expenditures.*

Fiscal Budget Determinations (Repeal Plan 3 Gain Sharing only):

As a result of the lower required contribution rates, the decrease in funding expenditures is projected to be:

Costs (in Millions):	**PERS**	**TRS**	**SERS**	**Total**
2005-2007				
State:				
General Fund	$(8.0)	$(80.4)	$(28.1)	$(116.5)
Non-General Fund	(13.3)	0.0	0.0	(13.3)
Total State	**$(21.3)**	**$(80.4)**	**$(28.1)**	**$(129.8)**
Local Government	$(18.9)	$(16.5)	$(25.0)	$(60.4)
Total Employer	$(40.2)	$(96.9)	$(53.1)	$(190.2)
Total Employee	$0.0	$0.0	$0.0	$0.0
2007-2009				
State:				
General Fund	$(9.0)	$(89.6)	$(34.2)	$(132.8)
Non-General Fund	(14.9)	0.0	0.0	(14.9)
Total State	**$(23.9)**	**$(89.6)**	**$(34.2)**	**$(147.7)**
Local Government	$(21.2)	$(18.3)	$(30.3)	$(69.8)
Total Employer	$(45.1)	$(107.9)	$(64.5)	$(217.5)
Total Employee	$0.0	$0.0	$0.0	$0.0
2005-2030				
State:				
General Fund	$(208.8)	$(2,014.7)	$(810.1)	$(3,033.6)
Non-General Fund	(344.5)	0.0	0.0	(344.5)
Total State	**$(553.3)**	**$(2,014.7)**	**$(810.1)**	**$(3,378.1)**
Local Government	$(490.6)	$(412.6)	$(718.4)	$(1,621.6)
Total Employer	$(1,043.9)	$(2,427.3)	$(1,528.5)	$(4,999.7)
Total Employee	$0.0	$0.0	$0.0	$0.0

Fiscal Budget Determinations (Benefit Improvements only):

As a result of the higher required contribution rates, the increase in funding expenditures is projected to be:

Costs (in Millions):	**PERS**	**TRS**	**SERS**	**Total**
2005-2007				
State:				
General Fund	$5.3	$24.4	$11.7	$41.4
Non-General Fund	8.8	0.0	0.0	8.8
Total State	**$14.1**	**$24.4**	**$11.7**	**$50.2**
Local Government	$12.5	$5.0	$10.4	$27.9
Total Employer	$26.6	$29.4	$22.1	$78.1
Total Employee	$18.1	$6.4	$2.6	$27.1
2007-2009				
State:				
General Fund	$6.5	$28.2	$12.8	$47.5
Non-General Fund	10.7	0.0	0.0	10.7
Total State	**$17.2**	**$28.2**	**$12.8**	**$58.2**
Local Government	$15.2	$5.8	$11.4	$32.4
Total Employer	$32.4	$34.0	$24.2	$90.6
Total Employee	$20.8	$8.9	$3.6	$33.3
2005-2030				
State:				
General Fund	$149.8	$730.1	$190.7	$1,070.6
Non-General Fund	247.2	0.0	0.0	247.2
Total State	**$397.0**	**$730.1**	**$190.7**	**$1,317.8**
Local Government	$352.1	$149.5	$169.1	$670.7
Total Employer	$749.1	$879.6	$359.8	$1,988.5
Total Employee	$401.2	$356.9	$114.7	$872.8

Fiscal Budget Determinations (All Changes):

As a result of the lower required contribution rates, the decrease in funding expenditures is projected to be:

Costs (in Millions):	**PERS**	**TRS**	**SERS**	**Total**
2005-2007				
State:				
General Fund	$(2.7)	$(56.0)	$(16.4)	$(75.1)
Non-General Fund	(4.5)	0.0	0.0	(4.5)
Total State	**$(7.2)**	**$(56.0)**	**$(16.4)**	**$(79.6)**
Local Government	$(6.4)	$(11.5)	$(14.6)	$(32.5)
Total Employer	$(13.6)	$(67.5)	$(31.0)	$(112.1)
Total Employee	$18.1	$6.4	$2.6	$27.1
2007-2009				
State:				
General Fund	$(2.5)	$(61.4)	$(21.4)	$(85.3)
Non-General Fund	(4.2)	0.0	0.0	(4.2)
Total State	**$(6.7)**	**$(61.4)**	**$(21.4)**	**$(89.5)**
Local Government	$(6.0)	$(12.5)	$(18.9)	$(37.4)
Total Employer	$(12.7)	$(73.9)	$(40.3)	$(126.9)
Total Employee	$20.8	$8.9	$3.6	$33.3
2005-2030				
State:				
General Fund	$(59.0)	$(1,284.6)	$(619.4)	$(1,963.0)
Non-General Fund	(97.3)	0.0	0.0	(97.3)
Total State	**$(156.3)**	**$(1,284.6)**	**$(619.4)**	**$(2,060.3)**
Local Government	$(138.5)	$(263.1)	$(549.3)	$(950.9)
Total Employer	$(294.8)	$(1,547.7)	$(1,168.7)	$(3,011.2)
Total Employee	$401.2	$356.9	$114.7	$872.8

STATEMENT OF DATA AND ASSUMPTIONS USED IN PREPARING THIS FISCAL NOTE:

The costs presented in this fiscal note are based on our understanding of the bill as well as generally accepted actuarial standards of practice including the following:

1. Costs were developed using the same membership data, methods, assets and assumptions as those used in preparing the September 30, 2003 actuarial valuation report of the Teachers Retirement System, School Employee's Retirement System, and Public Employee's Retirement System. Costs for the repeal of gain sharing and the SERS 3 contribution were based on the Aggregate Cost Method. Costs for the Rule of 90 and Choice were based on the Entry Age Normal Cost Method.

2. As with the costs developed in the actuarial valuation, the emerging costs of the System will vary from those presented in the valuation report or this fiscal note to the extent that actual experience differs from that projected by the actuarial assumptions.

3. Additional assumptions used to evaluate the cost impact of the bill which were not used or disclosed in the actuarial valuation report include the following:

Rule of 90

Kicker Added to Retirement Probability

Age	PERS Male	PERS Female	SERS Male	SERS Female	TRS Male	TRS Female
60	0.44	0.33	0.38	0.45	0.45	0.45
61	0.29	0.22	0.25	0.30	0.30	0.30
62	0.29	0.16	0.25	0.20	0.30	0.20
63	0.11	0.16	0.25	0.20	0.25	0.20
64	0.11	0.16	0.25	0.20	0.25	0.20

The kicker (additional retirement rate) is added to the retirement probability at the age when a member is first eligible for the Rule of 90. For each year after the year first eligible, 25% of the kicker is added.

4. The analysis of this bill does not consider any other proposed changes to the system. The combined effect of several changes to the system could exceed the sum of each proposed change considered individually.

5. This fiscal note is intended for use only during the 2005 Legislative Session.

6. The funding method used for Plan 1 utilizes the Plan 2/3 employer/state rate as the Normal Cost and amortizes the remaining liability (UAAL) by the year 2024. Benefit increases to Plan 2/3 will change the UAAL in Plan 1. The cost of benefit increases to Plan 1 increases the UAAL.

7. Plan 2/3 utilizes the Aggregate Funding Method. The cost of Plan 2/3 is spread over the average working lifetime of the current active Plan 2/3 members.

8. The cost increases/(decreases) for the bill used to determine the increase in funding expenditures for future new entrants are 0.18% for PERS Plan 2 members, (0.07%) for PERS employers, 0.48% for TRS Plan 2 members, (0.73%) for TRS employers, 0.33% for SERS Plan 2 members, and (1.62%)% for SERS employers. These includes a cost of 0.14% for TRS members and employers and 0.16% for SERS members and employers for choice.

GLOSSARY OF ACTUARIAL TERMS:

Actuarial Present Value: The value of an amount or series of amounts payable or receivable at various times, determined as of a given date by the application of a particular set of Actuarial Assumptions (i.e. interest rate, rate of salary increases, mortality, etc.)

Projected Benefits: Pension benefit amounts which are expected to be paid in the future taking into account such items as the effect of advancement in age as well as past and anticipated future compensation and service credits.

Normal Cost: Computed differently under different funding methods, the normal cost generally represents the portion of the cost of projected benefits allocated to the current plan year.

Actuarial accrued liability: Computed differently under different funding methods, the actuarial accrued liability generally represents the portion of the present value of fully projected benefits attributable to service credit that has been earned (or accrued) as of the valuation date.

Unfunded Actuarial Accrued Liability (UAAL): The excess, if any, of the actuarial accrued liability over the actuarial value of assets. In other words, the present value of benefits earned to date that are not covered by plan assets.

Pension Benefit Obligation (PBO): The portion of the Actuarial Present Value of future benefits attributable to service credit that has been earned to date (past service).

Unfunded Liability (Unfunded PBO): The excess, if any, of the Pension Benefit Obligation over the Valuation Assets. This is the portion of all benefits earned to date that are not covered by plan assets.